choices IRPP

family policy

Vol. 4, no. 2
May 1998
ISSN 0711-0677

subsidizing Child Care for low-income families:

a good bargain for canadian governments?

gordon Cleveland

and

douglas Hyatt

University of Toronto

Monique Jérôme-Forget
Foreword 2

The Current Child Care Subsidy System in Canada 5

Improving Canada's Child Care Subsidy System 9

The Public Finance Case for Increasing Public Expenditure on Child Care Subsidies 18

Conclusions 26

Foreword

The deficit reduction effort by Canadian governments in recent years has projected value-for-money considerations to the forefront of public policy debates. In general, the deficit constraint has forced society to prioritize its use of scarce resources, with somewhat different choices emerging across jurisdictions. In the field of social policy, however, programmes everywhere are now aimed more at integrating beneficiaries into productive employment, and are less accommodative of maintaining dependence upon state support. Furthermore, Canadian social policy is evolving away from the universal entitlements model of the post-war period in favour of targeting only the most needy.

In this context, a review of the cost-effectiveness of Canadian child care subsidies is most appropriate. Subsidized child care assists low-income parents in joining the labour force, which matches the broad trend in social policy toward active rather than passive measures. Also, this study comes at a time of transition in the wake of federal reforms which ended 30 years of explicit federal-provincial cost-sharing for child care subsidies under the Canada Assistance Plan, and which effectively leave the provinces with full control over programme design in this area. To date, there has been little public debate in Canada about changes to child care subsidies, other than in Quebec, where the government has introduced subsidized child care at $5 per day for all families with young children regardless of income. As Professors Cleveland and Hyatt point out in this study, there already exists a considerable variety of programme characteristics among Canadian provinces, and recent developments suggest a further increase in this diversity, with some provinces (notably Quebec, and to some extent British Columbia) designing broader subsidies while most other provinces contract their programmes.

The study's first main objective is to review the current child care subsidy system and highlight the main directions shaping its evolution. The authors examine the various provincial programmes and highlight their common features. The main parameters which emerge are: social criteria, by which most recipients must either be employed, looking for employment or being trained for employment; financial criteria, by which the proportion of subsidy is dependent on net family income in relation to some "turning point" above which the subsidy begins to be "taxed-back"; minimum user fees and/or subsidy ceilings beyond which parents must pay the difference in day-care costs; and requirements as to the quality of day-care which is subsidized. The authors note that due to low turning points for child care subsidy eligibility, the vast majority of subsidies go to single-parent (generally lone mother) families.

Secondly, the study examines how the provincial/territorial child care subsidy systems affect work incentives and employment for single-parent families, and how they could be re-designed to better achieve their objectives. To analyze the effect on work incentives of day-care subsidies, Professors Cleveland and Hyatt construct a composite approximation of the current subsidy system and compare it with alternatives derived by modifying key programme characteristics. Taking into account the effect of both the tax system and benefits on disposable income of parents, they find that there are now some

incentives to work for lone parents who earn very modest incomes, but that the additional income retained from this employment is very small. According to the authors' model, earning $8,000 per year, for example, results in an improvement of only $2,300 in comparison with simply collecting social assistance benefits. Earning $16,000 per year results in an improvement of about $3,400 in disposable income. "These improvements," the authors note, "are often not enough to encourage lone parents to seek regular employment, even when the job market is good."

The authors demonstrate that work incentives could be improved either by eliminating the minimum fee, reducing the tax-back rate, or increasing the turning point. Increasing the turning point appears to have the biggest effect on disposable income. In order to gain the strongest possible incentives, the authors recommend a subsidy model in which parents can earn a net income of $19,000 before subsidies begin to be taxed-back, ideally at a reduced rate of 25 percent, rather than the 50 percent rate which is currently in place in most jurisdictions. For the same reason, Cleveland and Hyatt recommend that minimum fees payable by parents should be reduced or eliminated.

The study's third main objective is to investigate the public finance effects of child care subsidies, to determine whether they increase or reduce net government spending when social assistance and other savings are taken into account. The authors find that the answer depends crucially on the average earnings of parents who move off social assistance and into employment. A modest increase in family income brings a reduction in social assistance and other benefits which is not enough to outweigh completely the increased child care costs incurred by the government. However, if lone parents can earn close to $20,000 annually, more generous child care subsidies will "pay for themselves" from a public finance point of view. Interestingly, the authors show that the costs of a move in the opposite direction — that of reducing the generosity of child care subsidies — unambiguously exceed the savings in subsidies costs, given the hike in social assistance payments which would result.

Professors Cleveland and Hyatt point out that the paper does not attempt a full cost-benefit accounting of the impact of child care subsidies on society. Longer-term benefits such as maintaining the human capital of lone parents and supporting child development are additional justifications for these subsidies. What is demonstrated here is that there is a reasonable short-term, fiscal case for providing more generous child care subsidies. The study's findings suggest that current subsidies do not offer optimal incentives for encouraging lone parents out of dependence on social assistance. And as governments acquire more fiscal room with the loosening of the deficit constraint, the case for improving the incentive effect through increased public expenditure on child care subsidies can only become more compelling.

Monique Jérôme-Forget
President, IRPP

It is well known that most lone mothers in Canada have low incomes. About 60 percent of lone mothers in the early 1990s had annual incomes below Statistics Canada's Low Income Cut-Offs (LICOs); they included about 75 percent of lone mothers below 35 years of age, who are likely to have young children.[1] It is not surprising, then, that close to 50 percent of lone mothers report that they receive social assistance income each year, including about 58 percent of lone mothers below 35 years of age. The percentage of these younger lone mothers who receive welfare has increased from 43 percent in the mid-1970s. Only about 20 percent of these younger lone mothers report that they are engaged in full-time/full-year employment.

Dooley[2] demonstrates that it is not difficult to explain the increased dependence on social assistance of young lone mothers. Increases in the proportion of young lone mothers who have never been married, changes in other demographic characteristics, falling real wage opportunities and the increased generosity of social assistance rates from the 1970s to the 1990s are sufficient to explain observed patterns. Nonetheless, the recognition that lone mothers often have long and/or repeated spells on social assistance,[3] combined with evidence that early welfare use is positively correlated with increased use at later ages,[4] has drawn attention to policies which may increase the employment rates of lone mothers with young children.

At the same time, there is evidence from cross-sectional studies that child care subsidies can have substantial effects on the probability that lone mothers will participate in the labour force and will leave welfare.[5] It is useful to consider in some detail how much effect child care subsidies can have, and whether expanding the availability of more generous subsidies makes social and financial sense.

It has long been contended that child care subsidies for low-income Canadians are a good deal for Canadian taxpayers, because they may facilitate employment and reduce dependence on welfare and other forms of assistance. If these effects are large enough, child care subsidies may "pay for themselves." Under these circumstances, a generous child care subsidy policy could appeal to voters of all political stripes. This paper considers the net financial costs of child care subsidies in Canada and finds that they may, indeed, be a good deal for Canadian taxpayers and governments. However, changes to child care subsidy policies in Canada could further improve the incentives and the support parents need to get employment.[6]

Of course, the social benefits of subsidized child care to low-income families may be substantially greater than the amount of the financial savings to governments. Increased access to good-quality child care is likely to have important effects on child development. The Perry Preschool Project, which provided early intervention child care and advice for parents, is well known for what has been calculated to be its seven to one ratio of benefits to costs.[7] Although this project's results are not directly applicable to Canadian child care subsidy policy, there is, nonetheless, strong evidence of developmental benefits for children in low-income families who receive good-quality child care services.

The focus of this paper is, by design, a very narrow one. This paper does not try to estimate the effects of child care on school readiness or other aspects of child development.[8] It only considers the effects on the employment of lone mothers and their resulting incomes. It does not seek to calculate all the benefits and costs of good-quality child care, but restricts its attention primarily to the public-finance implications of child care for governments.

Governments in Canada provide child care assistance in a number of ways: they include child care subsidies to low-income parents with young children; operating grants to licensed child care centres and to regulated child care providers in family homes; and tax relief for child care as a work-related expense.[9] The subsidizing of the child care costs of low-income parents is the longest-standing element of child care policy; federal-provincial cost-sharing was established in 1966 with the inauguration of the Canada Assistance Plan (CAP). This child care subsidy system is also perhaps the most complex and the least-studied component of child care policy.[10] Each province and territory has different rules concerning eligibility, payment and the types of child care that can be subsidized; Ontario's municipal-based system adds over one hundred additional permutations.

This paper steps into this research gap by focusing on the child care subsidy system. It seeks to address the following three questions:

1. How are the child care costs of low-income families subsidized currently and in what direction are these policies evolving?
2. How do provincial/territorial child care subsidy systems affect work incentives and employment for single-parent families, and how could they be re-designed to better achieve their objectives?
3. What are the public finance effects of child care subsidies? Do child care subsidies increase or reduce net government spending when social assistance and other savings are taken into account? Is it, even in this narrow sense, worth spending government money subsidizing the child care costs of low-income families?

The Current Child Care Subsidy System in Canada

All provinces and territories in Canada provide child care subsidies to low-income families in order to permit parents to work or get an education, while ensuring that children receive care of an acceptable quality. Child care is an area of provincial jurisdiction in Canada, but for the last 30 years, the federal government has paid 50 percent of the cost of these subsidies under CAP. The Canada Assistance Plan has been the chief method used to finance social assistance and the provision of welfare services since 1966. Child care has been a very minor part of CAP (typically about four percent of annual funding); however, child care has been seen as an important service both to alleviate the effects of poverty on children (to ameliorate their care) and/or to prevent poverty by allowing mothers (and other family members) to work, to look for work or to receive training for future work. The federal government

has established maximum amounts of net family income for different sizes of family beyond which it will not share the cost of child care assistance. Within these relatively generous limits, provinces have set their own financial and social criteria for eligibility, as well as often setting informal priorities for ranking needy families when resources have been insufficient to fund all those eligible. As a result, the generosity and structure of provincial and territorial child care assistance programs have been far from uniform. In fact, it is difficult to make any simple statement about Canada's child care subsidy system which is completely accurate; there is almost always a multitude of exceptions to any summary characterization of eligibility rules in any province or territory.

By setting aside some important details, it is possible, however, to recognize the broad similarity of structure and purpose in provincial/territorial child care assistance programs.[11] Although all jurisdictions have given some child care subsidies for child development purposes regardless of the employment or training status of the parents, the bulk of subsidies in most provinces/territories are designed to permit mothers in lone-parent or two-parent families to get employment or training,[12] while their children are cared for by trained caregivers in a safe, reliable setting. Most provinces/territories have chosen in the past (and according to regulations under CAP) to restrict subsidies to use in licensed child care arrangements (centres, family day care homes, and often nursery schools). British Columbia has, however, for some years permitted subsidies to be used to purchase the services of unregulated neighbourhood sitters or in-home caregivers. Many other provinces have recently, without much fanfare, found ways to provide subsidies to families using informal child care.

Table 1 gives a brief indication of the rules and conditions governing child care subsidies in different provinces and territories. Needless to say, the rules are not uniform. However, the various child care subsidy systems are broadly similar in form and can be described in the following manner:

- Social Criteria —Applicants should be employed, looking for employment or being trained for employment (subsidies are given to families who are not employed if there are special risks in relation to child development or treatment, but we do not focus in this paper on subsidies given for this reason);
- Financial Criteria — Families must have a total net (after income and payroll taxes) income which is lower than some turning-point level in order to get a "full" subsidy; above that level of net income, the subsidy is reduced by 50 cents for each additional dollar of net income (there is some variation in this tax-back rate). Turning points vary according to the number of parents and the number of dependent children in a family. In many provinces, there is a restriction on the amount of assets a family can own as well;
- Minimum user fees and maximum subsidies — In many provinces, even "fully subsidized" families must pay a minimum user fee (there are generally some provisions for exceptions). Moreover, in many provinces, there is a limit to the amount that the authorities providing the subsidy will pay for care; if the child care used is more expensive than this, the parents must pay the difference. Maximum subsidy amounts will particularly affect parents of infants or toddlers whose annual child care fees are higher than those of children over three years of age.

Table 1

Features of Provincial/Territorial Child Care Subsidy Policies, 1995

Province or Territory	Turning Point: Single Parent, One Child* ($)	Turning Point: Two Parents, Two Children* ($)	Average Cost of Full-time Centre Care for 3-year old ($)	Tax-Back Rate (%)	Other	Number Subsidies ($)
BC	18,984	23,016	5,280	50	No minimum user fee, no cap on subsidized spaces; maximum subsidy approx. $4,350/year	28,920
Alberta	18,710	22,780	4,500	30, 60, 90	Minimum user fee of $480 per year, no subsidies for nursery schools; maximum subsidy approx. $3,550/year	13,159
Saskatchewan	19,668	20,828	4,296	50	Minimum user fee of 10% of cost, subsidies only to non-profits; maximum subsidy approx. $2,775/year	3,683
Manitoba	13,787	18,895	3,840	50	Minimum user fee $2.40 per day, limit on subsidized cases = 8600, non-profit only; maximum subsidy approx. $4,725/year	8,200
Ontario	15,998**	26,993**	***	100	Varies by municipality	#
Quebec	12,000	16,800	5,328	50	Minimum user fee of $1.00 per day, user must pay 40% of actual fee minus $4.00 per day. Maximum subsidy is $6,315/year	41,520
NB	15,000	15,000	4,476	50	No minimum; maximum subsidy $3,900/year	1,363
NS	16,812	17,712	4,800	50	Minimum user fee of $1.75/day, maximum fee of $3.00/day, limit on subsidies = 2250, waiting list averages 10 months; maximum subsidy of $4,381/year	2,200
PEI	10,080	14,880	4,500	50	No surcharge on subsidized parents; maximum subsidy $4,420/year	382
Newfoundland	9,960	11,040	4,560	50	No surcharge on subsidized parents	748
Yukon	17,772	26,172	6,000	50	No minimum fee; maximum subsidy approx. $2,660/year, non-profit centres only	680
NWT	Needs test	Needs test	6,360	100	No minimum user fee; maximum subsidy up to $8,273/year	350

Notes: * A turning point is the income level at which eligibility for full child care subsidy (a misnomer, since there are often minimum fees) ends and partial subsidy (a "taxing back" of part of full subsidy) begins. Eligibility is determined by "net income" – gross employment and/or social assistance income minus income and payroll taxes payable. In Saskatchewan, the turning point refers to gross income.

** Data from Ontario refers to Metropolitan Toronto. The child care subsidy system in Ontario varies from municipality to municipality.

*** Reliable data on average costs in Ontario are not available. Average costs are higher than in other provinces (perhaps $6,500-$8,000)

In 1995, there were estimated to be 73,400 subsidies in Ontario. This number may have decreased since then.

Source: Information from provincial/territorial officials and Child Care Resource and Research Unit, *Child Care: Provinces and Territories, 1995* (Toronto: Centre for Urban and Community Studies, University of Toronto, 1997).

- In nearly all provinces and territories, the vast majority of child care subsidies are used by parents to purchase licensed care, either in a child care centre or in a regulated family home. Licensed or regulated care must conform to a set of provincial/territorial regulations on staff-child ratios, training of staff, play space, etc. which are intended to ensure a minimum level of quality. In many provinces, subsidies may only be used to purchase care in non-commercial facilities; this latter restriction was encouraged by federal CAP cost-sharing legislation.

Due to low turning points for child care subsidy eligibility, the vast majority (70 percent – 90 percent) of subsidies go to lone-parent families,[13] according to provincial authorities.

Recent Changes in Child Care Subsidy Policies

Despite the intentions declared in the Liberals' Red Book to spend additional money on licensed child care services, this has not been the prevailing direction of government policy. There have been three major initiatives related to child care or children. The first has been the elimination of CAP which shared the cost of child care subsidies for low-income families. The Canada Health and Social Transfer (CHST) which replaced CAP in 1996 reduces total federal funding for combined health, education and social services by about $7 billion over several years. Equally as important, because the CHST is a lump-sum grant, every dollar spent on child care by the provinces now costs them $1.00 (whereas $1.00 of child care spending used to cost provinces $0.50 under CAP). The fiscal incentives for child care and social spending are therefore reduced.

The second federal initiative has been the increase in the Child Tax Benefit, which was designed to give additional money to families with young children. In the 1996 and 1997 Budget Speeches, the federal government announced additional money ($850 million annually) and changes to the Child Tax Benefit. Although some details remain to be negotiated with the provinces/territories, it is proposed that by July 1, 1998, the Child Tax Benefit will be increased (e.g., to $1,645 for a first child, from $1,020), while the Working Income Supplement (up to $500 per family) will be eliminated. The additional benefits from these changes to the Child Tax Benefit for families collecting most of their income in Social Assistance or from other government programs will, through changes in Social Assistance and other programs, be taken away from them. The money saved will be "reinvested" by provincial/territorial governments in programs for low-income families who are not on welfare (child care, supplementary health benefits, income support programs) as a way of increasing incentives for parents to work.

The third federal initiative, building on and encompassing the changes to the Child Tax Benefit, has been the announcement of a National Children's Agenda, the details of which are to be worked out between the provinces and the federal government.

Many provinces have, in the last two or three years, scaled back child care spending, thus reducing operating funding for licensed child care centres and freezing child care subsidies, or increasing required parental co-payments. Ontario has announced its intention to roll back wage supplements paid to workers in licensed child care centres and plans to relax the regulations restricting subsidies to use in licensed premises only. Many provinces have, in recent years, found ways to direct child care subsidies to use in unlicensed homes. Typically,

these provisions have applied only to particular categories of families (e.g., those receiving training allowances) rather than to all families. Many government social programs have changed considerably in recent years; child care subsidy systems have evolved more slowly. So far, most changes to child care subsidies have been piecemeal and have received little public debate.

Regarding its child care policy, Quebec has chosen to move in almost the opposite direction from that recently pursued by the other provinces, as to some extent has BC. Quebec has announced its intention to provide universal child care (within the educational system) for children of employed parents, at a fixed subsidized price ($5.00 per day). This provision initially applies to four-year-old children (five-year-old children will receive full-day kindergarten) and will be extended each year to include eventually all preschool children.

Improving Canada's Child Care Subsidy System

It may well be legitimate to argue that the potential, widespread benefits of early childhood education for child development make the broad subsidizing of child care desirable. In fact, the early education of children could be seen as the most promising frontier in the development of Canada's educational system. The current child care subsidy system is, however, by its nature, targeted rather than broad or universal. This section adopts the narrow focus of considering ways of improving the design of a targeted form of child care subsidy.

It is not possible to design something without a set of objectives. The fundamental objectives of a targeted child care subsidy system would seem to be two-fold: to remove disincentives that discourage low-income mothers[14] of young children from seeking employment, and to ensure that their children who might be at risk of delayed development receive stimulating, caring, age-appropriate child care while the mother is employed. The disincentives that discourage mothers of young children from seeking employment are very strong if those mothers are eligible for social assistance payments, as are most lone mothers (we explore this issue in some depth below). Moreover, there is evidence[15] that most parents do not judge child care quality very accurately, and that low-resourced families, when left to their own devices, are more likely to place their children in custodial, rather than in developmental, child care. These twin concerns provide the rationale for some amendments to current child care subsidy programs in Canada's provinces and territories.

Comparing Child Care Subsidy Plans

All of the provincial/territorial subsidy systems that use income tests, rather than needs tests,[16] can be described using the following, five parameters: a working/training eligibility criterion; a turning-point level of net income; a tax-back or benefit-reduction rate as income rises; a minimum amount payable by the parent (either through a minimum fee or a maximum subsidy) even on a "full subsidy"; and the enumeration of the types of care purchasable with this subsidy.

Below, we examine the effects of the child care subsidy system on the decisions made by families with young children. To facilitate this exercise, we describe an approximation to Canada's existing subsidy system (see Table 1) and compare it with possible alternatives. The approximation used has these components:

- it refers, for the sake of simplicity, only to single-parent families with one preschool child;
- parents are eligible for a subsidy only if they are employed;
- subsidies must be used to purchase licensed care, which costs $5,000 per year;
- the turning point (where a "full" subsidy ends) is $16,000 of after-tax (net) income;
- either through minimum fees or a maximum fee limit, or both, each family pays the first $1,000 of their child care fee (about $4.00 per day), even if eligible for a "full" subsidy;
- the tax-back rate is 50 percent (by implication, the "break-even" point at which partial subsidy ends is at $24,000 of net income).

In shorthand form, this approximation to the existing subsidy system can be described as "M1650," where M refers to the $1,000 minimum payment, 16 refers to the $16,000 turning point, and 50 refers to the tax-back rate. We will compare this with a set of plausible alternatives (see list below),with modified turning point, tax-back and minimum fee parameters. Other rules are assumed to remain constant. Having "no subsidy system" and a "full subsidy" (where the parental co-payment is zero) are two other alternatives (see Table 2).

- 01650 — the same turning point (16,000) and tax-back rate (50 percent) as the current system, but with no minimum fee;
- M1625 — the same turning point and minimum fee as the current system, but with a reduced tax-back rate (25 percent);
- M1950 — the same tax-back rate as the current system and the same minimum fee, but a higher turning point (19,000), giving more families a "full" subsidy;
- 01925 — a subsidy system which is more generous on all counts with no minimum fee, a higher turning point and a lower tax-back rate;
- 01425 — a subsidy system which has no minimum fee, has a lower tax-back rate than the current system, but compensates for this generosity with a lower level of turning point income (14,000).

To show the effect of different eligibility rules for child care subsidy on work incentives, we calculate the take-home income (after-tax, and after child care expenses have been paid) of a typical single-parent family with a preschool child. The mother in this family has, we assume, the choice of being employed or not. If she is not employed, she will be eligible for Social Assistance.[17] If she is employed, she will receive employment income and some Social Assistance, but her Social Assistance benefits will decrease rapidly as her earnings increase. Employed mothers will also have to pay for child care, unless their child care costs are fully subsidized.[18] Table 2 shows the take-home incomes of these families for different possible annual levels of earnings — from $6,000 to $26,000 — and for differently designed child care subsidy systems, as described above. Table 2 calculates the net effect on incomes of earnings, social assistance, the new Child Tax Benefit, the GST tax credit, Canada Pension Plan and Employment Insurance premiums, those child care costs which are not covered by child care subsidies, income taxes and the Child Care Expense Deduction. The exact assumptions behind these calculations are detailed in Appendix A.

Table 2 presents a considerable amount of information about the incentives single mothers have to seek and retain employment.

It deserves careful consideration. First, it should be noted that any mother who is not employed (full-year gross earnings = $0) has an income of $13,361 per year. Most of this comes from Social Assistance, but the enhanced Child Tax Benefit and the GST Tax Credit provide a supplement to Social Assistance.

The first column in the body of the table, labelled "No Subsidy System," shows why child care subsidies are practically essential if lone mothers are going to have any incentive to leave Social Assistance. Any mother whose employment earnings are lower than $12,000 per year is worse off when employed after full child care costs are deducted. Even a mother who earns $20,000 per year is only better off by $3,000 per year. Given that employment means extra clothing costs, transportation costs, potential loss of dental and health benefits, and loss of time for organizing the household, most mothers would probably consider that employment makes no economic sense.

The effects of the current subsidy system (assuming that subsidized child care spaces are available) are shown in the second column in the body of the table, under the heading "Current Subsidy System — M1650." There now are some incentives to work for mothers who earn very modest annual incomes (e.g., $8,000 — $16,000). But the additional income retained from this employment is small. Earning $8,000 per year results in an improvement in take-home income of only $2,300 in comparison with simply collecting Social Assistance. Earning $16,000 per year results in an improvement of about $3,400 in take-home income. These improvements are often not enough to encourage lone parents to seek regular employment, even when the job market is good.

Part of the reason why the returns from employment are so small is, of course, the tax-back, or benefit-reduction, which is built into Social Assistance. In most provinces, some amount of employment earnings is allowed before this taxing-back of benefits occurs, but only two or three thousand dollars are exempted. After that, typically, three out of every four dollars of employment earnings go back to government, and only one out of four dollars is left with the lone mother and her family.

The design of the current child care subsidy system also makes the returns from employment lower than they might otherwise be. The easiest way to see this in Table 2 is to look at the final column entitled "Full Subsidy." This column shows the take-home income of a lone mother if all child care costs were covered by a subsidy, at all earnings levels. The income gain from working at a job paying $8,000 per year (compared with being on Social Assistance exclusively) is now about $4,000. The income gain from earning $16,000 per year is about $6,100. These figures are 75 — 80 percent higher than under the current subsidy system.

The other columns in Table 2 indicate that the alternative designs for the child care subsidy system affect the amount of take-home income at different earnings levels, and therefore affect work incentives. The subsidy alternative designated 01925, where families are not required to pay a minimum fee for child care, where the "turning point" is at $19,000 of net income, and where the tax-back rate is 25 percent, provides the strongest work incentives of the alternatives shown. At low levels of earnings, these are very close to the incentives provided by a "full" subsidy.

Table 2

Take-Home Income of Lone Parents Eligible for Social Assistance Under Alternative Child Care Subsidy Schemes

Full-year Gross Earnings ($)	No Subsidy System ($)	Current Subsidy System – M1650 ($)	01650 ($)	M1625 ($)	M1950 ($)	01925 ($)	01425 ($)	Full Subsidy ($)
0	13,361	13,361	13,361	13,361	13,361	13,361	13,361	13,361
6,000	11,609	15,304	16,304	15,456	15,609	16,609	15,956	16,609
8,000	12,318	15,664	16,664	15,996	16,328	17,328	16,496	17,328
10,000	12,914	15,957	16,957	16,435	16,914	17,914	16,935	17,914
12,000	13,500	16,250	17,250	16,875	17,500	18,500	17,375	18,500
14,000	13,873	16,358	17,434	17,124	17,845	18,782	17,642	18,995
16,000	14,460	16,708	17,676	17,523	18,160	19,189	17,999	19,484
18,000	15,032	16,950	17,918	17,880	18,401	19,546	18,356	19,932
20,000	16,515	17,571	18,428	18,606	18,857	20,006	19,006	20,478
22,000	18,017	18,423	19,281	19,803	19,709	21,203	20,203	21,980
24,000	19,496	19,496	20,015	20,979	20,544	22,379	21,379	23,459
26,000	20,970	20,970	20,947	22,151	21,376	23,551	22,551	24,933

Note: See Appendix A for details about the calculations used to produce these figures.

The Economically Efficient Amount of Work Incentive

There has long been debate about how much of an incentive should exist for lone mothers making decisions about labour force participation. It was widely believed 20 or 30 years ago that lone mothers should stay home with their children when they were young; now many policy-makers favour encouraging employment participation no matter what the child's age. Some will argue that if a lone mother has very few job skills or little education, labour force participation makes no sense; others will argue that for the long-term future of this mother and her family, this low-skilled worker should be encouraged to maintain and, through training, increase her skills and her continuity of work experience. Even economists who see no special social benefit from encouraging lone mothers into employment would, however, agree that individuals should at least be paid the full value of their current net marginal product in employment as a work incentive. In other words, if the lone mother can earn $10,000 for her labour and the cost of her child care is $5,000, the minimum appropriate work incentive for her to make the most efficient employment decision would be $10,000 -$5,000 = $5,000.

The current subsidy system which appears in Table 2 does not score very well by this criterion. Lone mothers are offered much less than their net marginal product as an incentive to get off social assistance. For instance, the mother earning $10,000 annually, who has a net marginal product of $5,000, takes home a net increase (compared to Social Assistance) of $2,596. At $20,000, where the net marginal product of her employment is $15,000, she would have an income gain of $4,210 in comparison with being on social assistance with no employment earnings. It is true that lone mothers earning $6,000 annually, with a net marginal product of only $1,000, will receive a net income increase greater than this, but in terms of the number of dollars received the incentive is so small as to provide little encouragement to enter the labour force in any case.[19] It is possible that some of the amendments to social assistance currently being discussed by the provinces/territories (increasing benefits for low-income, employed families and reducing social assistance benefits correspondingly) will change these incentives somewhat. However, at present, even a full child care subsidy does not, in general, provide overly generous work incentives, judged from the point of view of a narrow definition of economic efficiency.

Improving the Design of Child Care Subsidies

Charts 1, 2 and 3 show the information from Table 2 in a useful way. These charts permit us to visualize the effect of different features of the child care subsidy system on work incentives for lone-mother families at different earnings levels.

Chart 1 poses the basic dilemma. The slope of each of the three lines is not very steep. In other words, disposable income (i.e., take-home income after all benefit-reductions, supplements and child care costs have been accounted for) does not increase very rapidly with increased employment earnings. The basic reason for this is that income is taxed back by Social Assistance authorities as earned income increases. Even if lone mothers get a full child care subsidy (the top line on the graph), the immediate financial benefits of working are modest. However, although child care subsidies

cannot turn a sow's ear into a silk purse, their design has important effects on work incentives. The lower line on the graph (with circles) indicates the disposable income available to a lone mother with no child care subsidy (assuming the cost of child care is $5,000 annually). Without child care subsidies, there is no financial incentive to work for low earnings and very little incentive below about $20,000 of annual earnings. As Chart 1 shows, the current child care subsidy system is an improvement on the "no subsidy" situation. The middle line on Chart 1 does slope upwards, so there is some incentive to work. However, once disposable income rises above the turning point of $16,000, the child care subsidy tax-back is added to the social assistance tax-back and the marginal incentive to increase earnings is negligible.

Chart 2 compares the effect on disposable income of changes in each of the key parameters of the child care subsidy system: the minimum fee, the tax-back rate, and the level of income at which "full subsidy" ceases (the turning point). The scale on the left hand side of this graph (and the next one) is different from that in Chart 1; the vertical axis begins at $10,000 so the lines appear to have a greater slope. The lower line on Chart 2 (with triangles) indicates the effect of our approximation of the current subsidy system (M1650). It is clear that either the elimination of the minimum fee (01650), or the reduction of the tax-back rate (M1625), or an increase in the turning point (M1950) would improve work incentives compared with the existing subsidy system. Elimination of the minimum fee increases disposable income at low levels of earnings, but does not reduce the combined effect of the two tax-back rates at higher earnings. Reducing the tax-back rate to 25 percent increases the disposable income of lone mothers above the turning point, thus providing them with additional incentives to increase their earnings. However, an increase in the turning point to $19,000 appears to have the biggest effect, increasing disposable income for each level of earnings in the range from about $6,000 upwards.

Chart 3 provides a couple of other comparisons of child care subsidy alternatives. The bottom line represents the existing subsidy system and the top line (with squares) represents disposable income under a full child care subsidy. The most visible middle line (with inverted triangles) shows the effect of eliminating minimum fees, reducing the tax-back rate, but simultaneously lowering the turning point to $14,000. It is obvious that the incentive to work is improved everywhere by this combination of changes, suggesting the importance of reducing both minimum fees and tax-back rates in order to improve work incentives. The most interesting result on this chart is perhaps the least visible. Only a small part of the 01925 line (with circles) is visible, on the right-hand side towards the top. It is apparent that the effects on disposable income of this subsidy system, with no minimum fee, a higher turning point and a lower tax-back rate are very similar to the effects of a full child care subsidy, within the range of earnings levels considered.

Projected Effects on Employment of Alternative Child Care Subsidies

How much of a difference are changes in work incentives likely to make for lone mothers? Alternative child care subsidy policies may, because of their effects on disposable income, have significant effects on the number of lone mothers who work. Cleveland and Hyatt[20] used data from the 1988 Canadian

Chart 1

Effect of Child Care Subsidies on Lone Mothers' Disposable Income at Different Levels of Earnings

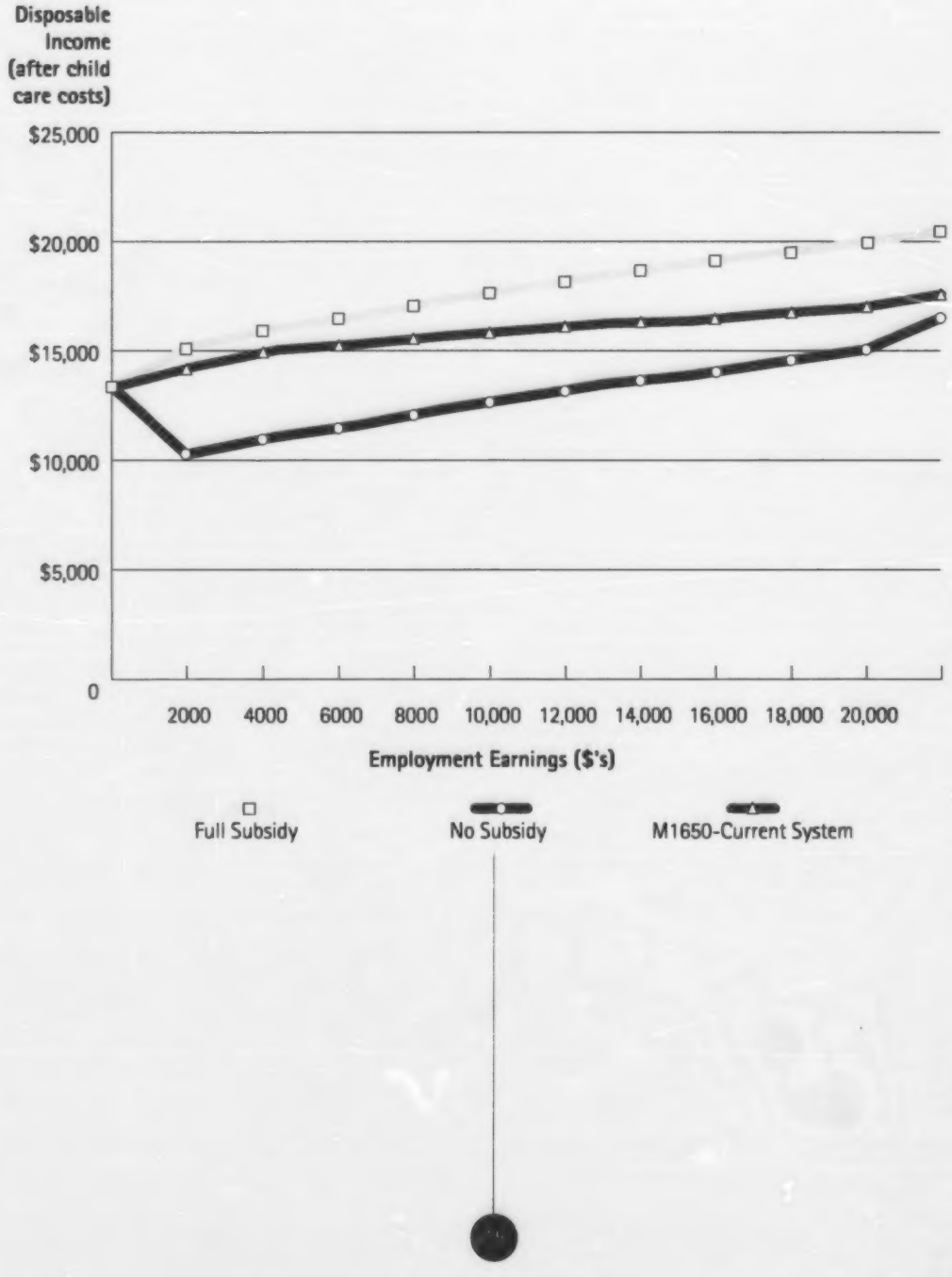


Chart 2

Effect of Child Care Subsidies on Lone Mothers' Disposable Income at Different Levels of Earnings

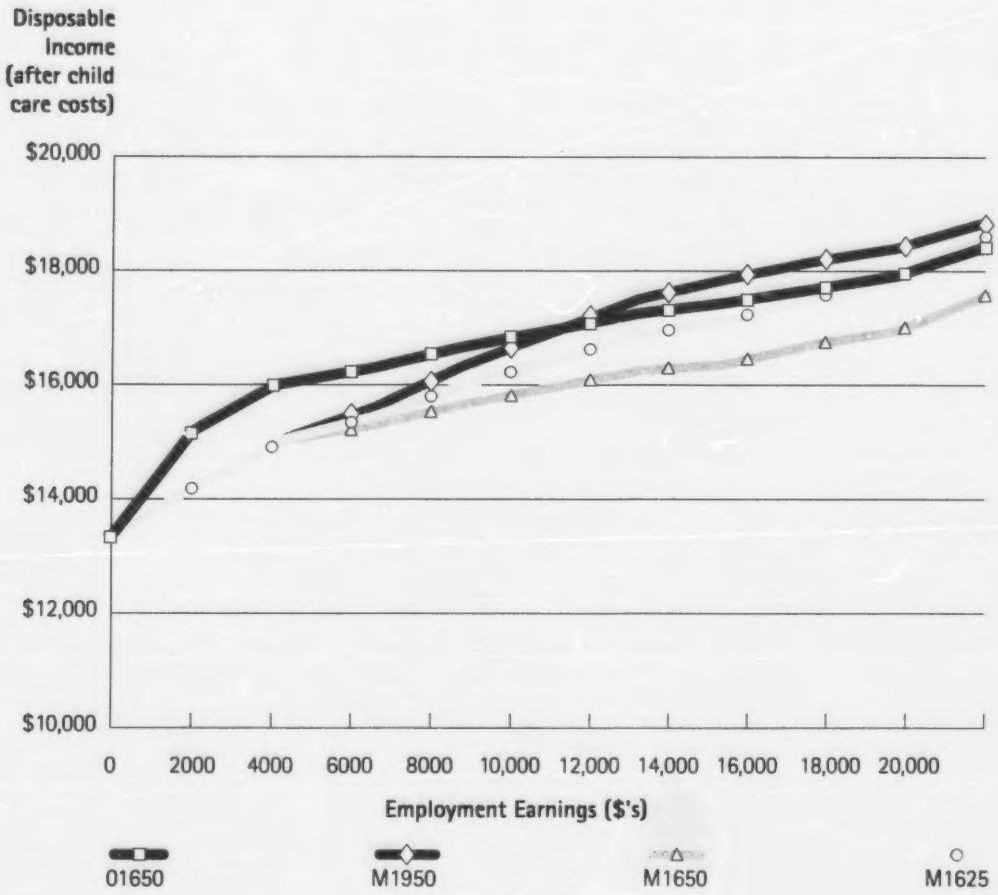
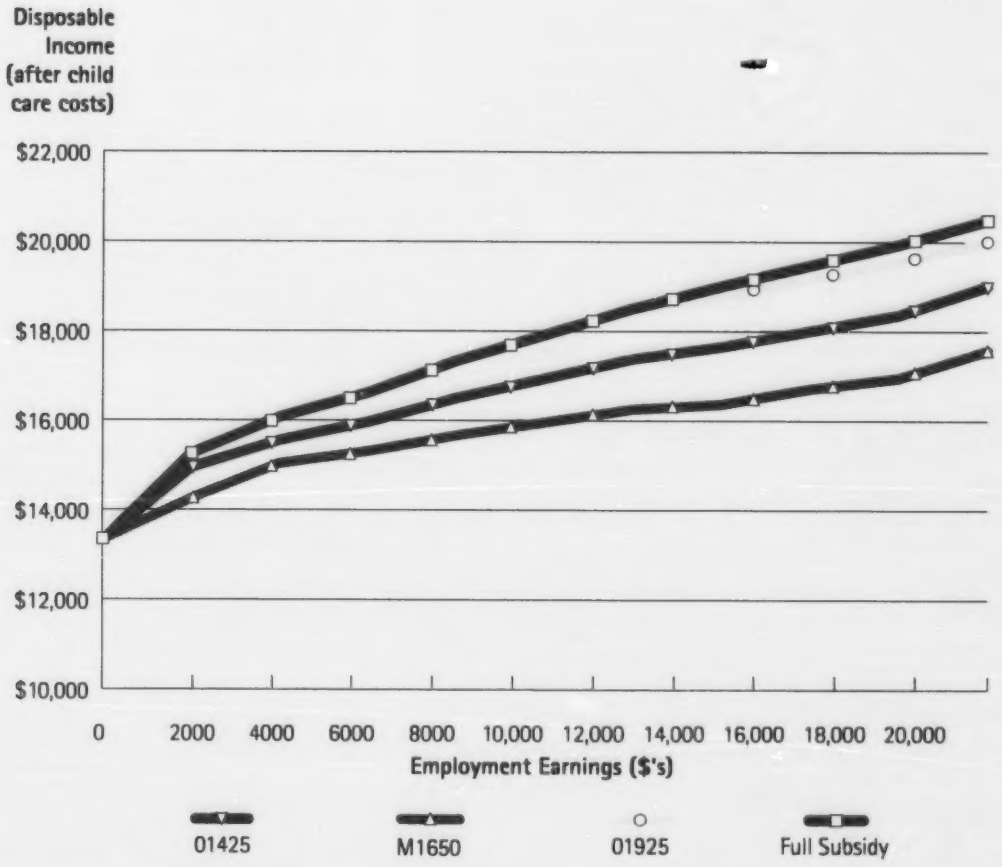


Chart 3

Effect of Child Care Subsidies on Lone Mothers' Disposable Income at Different Levels of Earnings



National Child Care Survey to estimate the effect of child care costs and levels of earnings on employment levels in lone mother families. Using parameter estimates from this study, we have calculated the simulated effects of alternative subsidy system designs on employment. These figures are recorded in Table 3.

According to these simulations, the employment of lone mothers is quite sensitive to child care subsidy policy, although Dooley[21] gives us various reasons to be skeptical about believing that lone-mother employment rates can be so easily affected (including the availability of jobs for those willing to work). It has been suggested[22] that for a considerable number of lone mothers who have insufficient education or have other employment disadvantages, child care is a necessary but not a sufficient condition for employment. However, other studies have also found considerable sensitivity of lone mother employment to child care prices.[23] Berger and Black find that a child care subsidy increases labour force participation by 25 percent. Jenkins finds a labour force participation elasticity to changes in child care costs of -0.18 and a full-time work elasticity of -0.24 (i.e., a 10 percent fall in child care costs would increase labour force participation by 1.8 percent and would increase full-time work by 2.4 percent). Kimmel finds an elasticity of labour force participation to child care costs of -0.33 in the 1994 paper and of -0.35 for black women and -0.136 for white women in the 1995 paper.

The Public Finance Case for Increasing Public Expenditure on Child Care Subsidies

We have seen that increasing the generosity of Canada's subsidy system to that of a system along the lines of 01925 would improve the economic efficiency of lone mothers' employment choices and would strongly encourage employment of these mothers. The sticking point for many governments is, however, the cost of child care subsidies. At several thousand dollars annually per child, these subsidies are not cheap. A full benefit-cost analysis of child care subsidies is beyond the scope of this paper, but we will look at an alternative calculation: the net cost of child care subsidies to government. The net cost subtracts the social assistance and other savings, as well as the increased tax revenues to governments, from the cost of child care subsidies.

The Net Cost of Child Care Subsidies

Table 4 provides some evidence for the net cost to governments of paying for different levels of child care subsidies (see Appendix A for a complete description of the calculations for this table). The table shows the

Table 3

Projected Employment Rates and Use of Market Child Care Under Alternative Child Care Subsidy Policies

Subsidy Policy	Employment Rate (%)	Use of Market Child Care (%)
Current Subsidy Policy M1650	41.3	78.2
01650	49.9	82.0
M1625	44.3	79.2
M1950	44.5	79.8
01425	51.4	81.5
01925	55.4	82.7
Full Subsidy	60.5	84.3

cost to governments of providing welfare and various other types of financial assistance to a single-parent family with one preschool child; this includes the effects of taxes and tax benefits but not the various provincial financial supplements. The first row in the body of the table shows the net cost to governments of a family where the parent has no employment earnings. Since we assume that this family does not use child care, the net cost of $13,361 is the same whether there is no child care subsidy program (Column 1), whether the generosity of child care subsidies is approximately that of the current provincial average (Column 2), or whether child care subsidies pay 100 percent of child care costs (Column 3). The remaining rows of Table 4 show the net cost to governments as the parent enters the labour force and earns, through employment, different possible amounts between $6,000 per year and $26,000 per year.

The essential message of the calculations shown in Table 4 is clear. The net total of social assistance and other costs to government declines substantially as individuals enter the labour force and earn larger annual amounts. This is still true if governments give substantial or even complete child care subsidies. For instance, if, under current subsidy arrangements, a lone mother, initially on social assistance, can earn $14,000 in pre-tax employment earnings, the net cost to government of supporting this family falls from about $13,400 annually to about $7,400 annually, even after allowing for the cost of the child care subsidy. If government provides a full child care subsidy, with no user co-payments, the savings to government are fewer (about $3,400), and the net cost falls to about $10,000 annually. Of course, a full child care subsidy would possibly be more effective in encouraging labour force participation and particularly full-time work.

Naturally, many lone mothers, even those with low incomes, do not collect social assistance. Some may have assets from a marriage or may be receiving some form of child support or alimony, allowing them to subsist with few or no employment earnings. Table 5 shows the net cost to governments of child care subsidies which affect this group of lone mothers who are not eligible for social assistance. The structure of the table is identical to that of Table 4.

Simulating The Net Cost of Child Care Subsidies

The public-finance cost of child care subsidies to lone mothers depends on the effect these subsidies have on different groups of lone mothers and on the number of families in each group. There are three groups of lone-mother families we need to consider. First, there are lone mothers who are currently not employed and who are collecting social assistance. Second, there are lone mothers currently not employed and not collecting social assistance. Third, there are lone mothers who are currently employed, and who currently use some form of child care. We shall continue to concentrate on lone mothers with preschool children, to whom the above tables apply; there are approximately 230,000 of these families in Canada, at present. It is difficult to determine even approximately how many lone mothers are in each of these categories. Dooley's[24] figures show that 58 percent of young lone mothers received social assistance income in the early 1990s. These figures are on an annual basis, rather than at a point in time, so these mothers may well, for instance, have worked for some portion of the year before or after being on social assistance. In fact, about two out of five of these young mothers who received social assistance earned some income from employment

Table 4

Net Cost to Government of Assistance to Lone-Mother Families Eligible for Social Assistance

Annual Pre-tax Employment Earnings ($)	1. Net Cost to Government - No Child Care Subsidy ($)	2. Net Cost to Government - Existing Child Care Subsidy Rules ($)	3. Net Cost to Government - Full Child Care Subsidy ($)
0	13,361	13,361	13,361
6,000	10,609	14,304	15,609
8,000	9,328	12,664	14,328
10,000	7,914	10,957	12,914
12,000	6,500	9,250	11,500
14,000	4,873	7,358	9,995
16,000	3,460	5,708	8,464
18,000	2,032	3,950	6,932
20,000	1,515	2,571	5,478
22,000	1,017	1,423	4,980
24,000	496	496	4,459
26,000	(30)	(30)	3,933

Note: See Appendix A for description of calculations.

Table 5

Net Cost to Government of Assistance to Lone-Mother Families *not* Eligible for Social Assistance

Annual Pre-tax Employment Earnings ($)	1. Net Cost to Government - No Child Care Subsidy ($)	2. Net Cost to Government - Existing Child Care Subsidy Rules ($)	3. Net Cost to Government - Full Child Care Subsidy ($)
0	2,256	2,256	2,256
6,000	2,256	6,256	7,256
8,000	2,361	6,361	7,361
10,000	2,361	6,361	7,361
12,000	2,256	6,256	7,256
14,000	2,043	5,929	6,892
16,000	2,043	4,824	6,421
18,000	1,986	3,698	5,949
20,000	1,515	2,571	5,478
22,000	1,017	1,423	4,980
24,000	496	496	4,459
26,000	(30)	(30)	3,933

Note: See Appendix A for description of calculations.

over the year, though only one in 20 was working full time, throughout the year. The remaining 42 percent of these young lone mothers did not collect social assistance. Most of the latter earned employment income (83 percent of them), though only two out of five were in full-time, full-year employment. For the purpose of our calculations, let us take the broad approximation that 50 percent of lone mothers with young children are on social assistance and not working substantially, another 40 percent are employed, and the final 10 percent are not employed and not collecting social assistance.

Simulations based on regression analysis of data from the Canadian National Child Care Survey of 1988 give us a basis for judging how many of each of these groups of lone mothers are likely to change their status based on changes in the generosity or availability of child care subsidies. Details of the models, samples and estimation procedures are provided in Cleveland and Hyatt;[25] the key model of interest estimates the effect of expected wages, child care prices and the level of social assistance income on the decisions of lone mothers with preschool children to be employed and to use market or non-market forms of child care.

With social assistance payments and expected wages remaining unchanged, simulations show considerable reponsiveness of lone mothers to the availability of assistance with child care costs. To get a sense of the degree of this responsiveness, we calculated the effect of three possible changes in the level of child care subsidy generosity. In the first simulation, the child care subsidy system as it applies to lone-parent families is made less generous than at present. Subsidy rules are changed from the current arrangements to a turning point for child care subsidy of $10,000 per year and a tax-back rate of 50 percent, with no minimum payment for child care. In other words, lone mothers with an annual income from all sources which was lower than $10,000 would get 100 percent of their child care costs paid, while those earning more would have to contribute 50 percent of their income over $10,000 (up to the actual cost of the child care). Under this set of subsidy rules, we would expect 35.9 percent of lone mothers with preschool children to be employed and 75.2 percent of them to use market forms of child care.

In the second and third simulations, the child care subsidy system is made more generous. The turning point is changed to $20,000 and $30,000 respectively, and the tax-back rate stays constant at 50 percent. The increased generosity of the second simulation is expected to increase lone mothers' employment to 54 percent, while 83.2 percent of those employed would use market child care. Finally, the $30,000 child care subsidy rule, allowing most lone mothers to be eligible for at least some subsidy, would increase employment to 57.7 percent and the use of market care by those employed to 84.6 percent.

Several assumptions are necessary to calculate the public-finance implications of these simulations. First, we assume that one-third of those who respond to the employment incentives of child care subsidy are currently not collecting social assistance, while two-thirds are. Second, we assume that the increased use of market child care reflects the increased use of now-subsidized licensed child care. Third, we assume that the average, newly-employed lone mother earns $14,000 per year in the first set of calculations, and $20,000 in the next set of calculations.[26] Fourth, we assume that about 50 percent of currently employed lone mothers using unlicensed market child care switch to subsidized licensed care in the second and third simulations (in other words, our calculations have to account for some substantial increased use of child care which is not linked to a decrease in

social assistance use). Fifth, for the sake of simplicity, we assume that each lone mother has only one preschool child (this is actually true of about 80 percent of lone mothers having preschool children). Table 6 shows the direct costs to government of different levels of generosity of child care subsidy using these assumptions.

Table 6 shows that the net cost of child care subsidies could be positive (cost increases outweigh savings), but it could also be negative (savings larger than increased costs). The net effect depends significantly on the average earnings of those who move off social assistance and into employment. The closer to $20,000 average earnings become, the more likely a generous child care subsidy program is to be of net financial benefit to governments.

The effects of making subsidy policy less generous are not in dispute. The top section of Table 6 indicates that when fewer single-parent families are eligible for child care subsidies, the increased costs of social assistance outweigh other savings. The savings in child care costs are not enough to make the net cost to government negative. Decreased eligibility for child care subsidies is a bad bargain for Canadian governments.

The middle and bottom sections of Table 6 show the financial effects of widening eligibility for child care subsidies. The turning point for eligibility is set in one instance at an annual income of $20,000, and in the other at $30,000. The net cost to government is strongly dependent on the potential earnings of social assistance recipients.

If lone mothers entering the labour force can only earn $14,000 annually, the reduction in social assistance and other benefits is not enough to outweigh completely the increased child care costs incurred by governments. For instance, if the turning point were set at $20,000, reduced social assistance and other benefits would bring savings of nearly $74 million to governments. However, it could happen that enough mothers who are not currently collecting social assistance would take up the more generous subsidies, and enough mothers who are currently employed would switch to subsidized, licensed child care, so that the net cost of these improvements to the child care subsidy system would equal $103.5 million.

However, if lone mothers can earn $20,000 annually, their eligibility for continuing benefits will diminish substantially, and improved child care subsidies will "pay for themselves." For instance, if the subsidy turning point is increased to $20,000, the saving to governments in social assistance and other benefits is projected to be $155 million. There are $40 million of extra costs to cover families whose mothers move from not currently collecting social assistance to take up the more generous subsidies. In addition, there are projected to be $86.2 million devoted to providing child care for mothers who were already employed but using informal child care. On balance, however, the more generous child care subsidies are projected to bring net savings of $28 million to government.

Of course, Table 6 is constructed on the very narrow presumption that there are no social benefits to the provision of child care other than the direct cost savings garnered by governments. This presumption is inappropriate on several counts. First, it is possible that the employment of mothers when their children are young will decrease social assistance participation over future years, because these mothers maintain their employment skills and increase their continuous work experience. In this case, there will be future reductions in government costs due to this year's child care subsidy. If the employment behaviour of mothers has an important influence on their children, decreased

Table 6

Estimated Change in Cost to Government of Changes in Child Care Subsidy Rules

	Newly Employed Earn $14,000	Newly Employed Earn $20,000
Reduce subsidy eligibility (to 01050 from M1650)	**(millions of dollars)**	**(millions of dollars)**
Changes in Social Assistance	+62.9	+96.0
Change for those not receiving Social Assistance	- 4.9	+1.8
Switches to/from informal care	- 14.8	- 14.8
Net Cost to Government	**+43.2**	**+83.0**
Increase subsidy eligibility (to 02050 from M1650)		
Changes in Social Assistance	-73.7	- 155.0
Change for those not receiving Social Assistance	+91.1	+40.8
Switches to/from informal care	+86.2	+86.2
Net Cost to Government	**+103.5**	**-28.0**
Increase subsidy eligibility (to 03050 from M1650)		
Changes in Social Assistance	-93.2	-184.5
Change for those not receiving Social Assistance	+113.0	+61.4
Switches to/from informal care	+86.2	+86.2
Net Cost to Government	**+106.0**	**-39.5**

Notes: Assumptions described in text. "Changes in Social Assistance" presents the net cost to government of those who move from Social Assistance to employment (or *vice versa*). "Change for those not receiving Social Assistance" presents the net cost to government of those who move from not receiving Social Assistance to employment (or *vice versa*). "Switches to/from informal care" presents the net cost to government of those already employed who switch from informal to formal child care (or *vice versa*).

social assistance costs and reduced poverty will have their influence on future generations.

Second, good-quality child care brings important, immediate benefits to children, and there is evidence both that these benefits are particularly substantial for children from low-income, low-resource families and that low-income families need some encouragement or direction to choose good-quality child care. For instance, in one of very few Canadian studies, Goelman and Pence have found that "children from low-resource families – that is, headed by single mothers with low levels of education, occupation and income – tended to be disproportionately enrolled in low quality family day care settings." The recent Cost, Quality and Child Outcomes Study in the US, conducted by a consortium of four academic institutions, found "a positive relationship...between child care quality and children's outcomes for all children, with an even stronger positive effect for typically at-risk children...."[27] These benefits to children in lone-mother families presumably apply regardless of whether mothers are moving from social assistance to employment, or whether already-employed mothers, encouraged by the availability of subsidies, are moving children from lower-quality unlicensed to higher-quality licensed child care.[28]

Conclusions

Given that most child care subsidies are directed toward lone mothers, and given that a substantial proportion of those mothers collect social assistance, the design of those subsidies needs to be explicitly tailored to encouraging mothers out of dependence on social assistance and into a permanent attachment to the labour force. Even from a narrow public-finance viewpoint, our projections indicate that child care subsidies are a good deal (in that they reduce immediate government spending), if the expected wages of lone mothers approach $20,000 annually. If the value of good-quality child care to child development is considered a benefit, then child care subsidies are likely to be considered a good deal no matter what the expected wages of the affected lone mothers.

We also consider alternative possible designs for a child care subsidy policy. We identify five key parameters which distinguish different provincial and territorial subsidy plans across Canada. These are a working/training eligibility criterion; a turning point level of net income; a tax-back rate; a minimum amount payable by the parent (either through a minimum fee or a maximum subsidy) even on a "full subsidy"; and the enumeration of the types of care purchasable with this subsidy. An effective child care subsidy system will tailor these parameters to best achieve desired objectives. The key objectives of the child care subsidy system are to remove disincentives that discourage low-income mothers of

young children from seeking employment, and to ensure that children who might be at risk of delayed development receive stimulating, caring, age-appropriate child care while their mothers are employed. This must be accomplished at a reasonable cost to the public purse.

We found that lone mothers on social assistance have only modest incentives to seek employment even when all child care costs are subsidized, and virtually no incentives to do so if child care subsidy is unavailable. Looking at information on current child care subsidy systems across Canada, we constructed an approximation to the "typical" subsidy system characterized by an effective minimum fee of $1,000 per year, with a turning point of $16,000 and a tax-back rate of 50 percent. Work incentives are diminished by the $1,000 co-payment and by the piling up of tax-back rates when employed lone mothers earn above about $8,000 per year.

In order to provide the desired employment incentives, child care subsidy systems should remain contingent on parental involvement in employment or training, particularly full-time employment or training, as is generally the case now. Minimum fees (and maximum payments well below the actual cost of care) should be reduced or eliminated. If there are problems with rising costs of licensed care, methods for containing them other than substantial parental co-payments should be found. The turning-point level of income should be raised to at least a net income of $19,000. Setting the turning point at this level allows lone mothers to earn about $20,000 in gross earnings, before the piling up of tax-back rates begins to diminish additional employment incentives. For most lone mothers, this will provide substantial employment incentives in the earnings region which they may reasonably hope to reach through employment.

Reduction of the child care subsidy tax-back rate to 25 percent would further improve employment incentives. Since this measure would also raise the break-even point (where even partial subsidy ends) and therefore substantially expand the eligible population, this may not be fiscally acceptable, unless subsidies are restricted to lone parents only.

Available research suggests that licensed child care has a strong, positive effect on the development of children from low-income families. The recent report of the National Longitudinal Study on Children and Youth[30] reminds us again that children from lone-parent families are more at risk of developmental problems than those from some other family types. Child care subsidies should be restricted to use in licensed child care facilities. It may be necessary for provinces and territories to expand the range of types of licensed facilities available to suit the increasingly diverse employment situations of modern-day Canada. Informal child care facilities, with no regulation or inspection, should not be considered an acceptable substitute to be subsidized by governments.

Appendix A

Calculating the Cost to Government of Child Care Subsidies

The financial implications of giving a child care subsidy to a particular family depend on many factors. First, it depends on what the family is currently doing. Assuming that we are interested in lone-mother families with one preschool child, the mother may be not employed and collecting social assistance, not employed but not collecting social assistance or may be currently employed.

Table 2 in the text calculates the take-home income (i.e., after taxes and child care costs) of lone parents who may be eligible for some social assistance. Take-home income varies according to the level of employment earnings of the family. Tables 4 and 5 calculate the net cost to governments of providing social assistance and/or other benefits to lone-parent families with different levels of employment earnings.

In reality, the cost to government of social assistance payments varies by province and by the particular characteristics of the family (e.g., eligibility or non-eligibility for housing subsidy). The cost of child care subsidies also varies by province, partly because the typical cost of child care varies and also because the amount of costs covered and the amount of expected co-payment vary. The tables and calculations in the text are based on an approximation of the "typical" rules for social assistance eligibility and the "typical" rules for child care subsidies. These approximations are described below. We assume that taxable income is subject to a 17 percent federal tax rate and an eight percent provincial rate. The value of other benefits which, in most cases, are uniform across the provinces, are described below.

Social Assistance

- If eligible for full assistance according to a needs test, a family receives $11,000 per year, which is not subject to federal or provincial income taxation.
- Earnings exemption (flat rate) for the first $2,400 per year ($200 per month) of net employment earnings. "Net" means after income taxes and payroll taxes (CPP and EI, if applicable). We assume that there is no exemption (sometimes called a "disregard") for child care expenses.
- Additional exemption of 25 percent of additional earnings beyond $2,400 per year of net employment earnings. Once the total amount of social assistance is "paid back," the family is no longer on social assistance.

Income Taxes

- Personal Amount ($6,456) and Equivalent-to-Spouse Amount ($5,380) mean that income taxation does not start until $11,836 of employment income. Even then, payroll tax deductions and child care expense deduction may delay income taxation until a higher income level is reached. After this, additional employment income is taxed at 17 percent federally and, we assume, eight percent provincially. There are some provincial tax credits but we will ignore these in these calculations.

Child Tax Benefit

- Based on recently announced changes: $1,645 per child (plus $213 per child minus

25 percent of the amount claimed for Child Care Expense Deduction). When the family earns income (gross income minus CPP, EI, and the amount of child care expenses claimed, and including social assistance payments as income) exceeding $20,921, it pays back 2.5 percent of its income until the CTB is repaid.

GST Tax Credit

- $199 plus $199 per child. Additional credit if a single parent has a net income which is greater than $6,456. This additional credit is $105 or two percent of income minus $6,456, whichever is less. If net family income is more than $25,921, the credit is reduced by five cents for each additional dollar of income.

Canada Pension Plan

- Earnings below $3,500 per year are not subject to this tax. Above this, the employee pays 2.8 percent toward CPP up to $35,400 (max contribution of $893.20).

Employment Insurance

- Employment Insurance contributions do not start until an individual works either 15 hours per week or earns $150 per week, whichever comes first. After that point, the individual pays 2.95 percent of all earnings (not on earnings above $150/week, as previously) in the form of EI premiums. This continues until annual earnings of $39,000 are reached (a maximum EI annual premium of $1,150.50).

Child Care Costs

- Assume that the annual unsubsidized full cost of child care is $5,000.

Child Care Expense Deduction

- A family is not eligible for CCED until employment income exceeds $11,836 plus payroll tax contributions (i.e., until paying income taxes). Child care expenses are deducted from income which is otherwise taxable. The amount claimed cannot exceed two-thirds of employment income. The maximum that may be claimed is $5,000 per child.

Child Care Subsidy Rules

- These vary by province, of course, and tend to be less generous in provinces where social assistance is also less generous. As an approximation, we assume that the turning point is at $16,000 of net income (net income defined as after income tax, but including social assistance income as income). We assume that the tax-back rate is 50 percent of net income. We assume that the minimum fee is $1,000 per year. The effective minimum fee can be explicit or may arise because the maximum amount covered by a full day care subsidy is less than the actual price of care or by a combination of the two.

Table B-1

Net Cost to Governments for Lone Mothers Eligible for Social Assistance, Under Alternative Child Care Subsidy Schemes

Full-year Gross Earnings ($)	No Subsidy System ($)	Current Subsidy System - M1650 ($)	01650 ($)	M1625 ($)	M1950 ($)	01925 ($)	01425 ($)	Full Subsidy ($)
0	13,361	13,361	13,361	13,361	13,361	13,361	13,361	13,361
6,000	10,609	14,304	15,304	14,456	14,609	15,609	14,956	15,609
8,000	9,328	12,664	13,664	12,996	13,328	14,328	13,496	14,328
10,000	7,914	10,957	11,957	11,435	11,914	12,914	11,935	12,914
12,000	6,500	9,250	10,250	9,875	10,500	11,500	10,375	11,500
14,000	4,873	7,358	8,434	8,124	8,845	9,782	8,642	9,995
16,000	3,460	5,708	6,676	6,523	7,160	8,189	6,999	8,464
18,000	2,032	3,950	4,916	4,880	5,401	6,546	5,356	6,932
20,000	1,515	2,571	3,428	3,606	3,857	5,000	4,006	5,478
22,000	1,017	1,423	2,281	2,803	2,709	4,203	3,203	4,980
24,000	496	496	1,115	1,979	1,544	3,379	2,379	4,459
26,000	(30)	(30)	(53)	1,151	376	2,551	1,551	3,933

Table B-2

Net Cost to Governments for Lone Mothers not Collecting Social Assistance, Under Alternative Child Care Subsidy Schemes

Full-year Gross Earnings ($)	No Subsidy System ($)	Current Subsidy System - M1650 ($)	01650 ($)	M1625 ($)	M1950 ($)	01925 ($)	01425 ($)	Full Subsidy ($)
0	2,256	2,256	2,256	2,256	2,256	2,256	2,256	2,256
6,000	2,256	6,256	7,256	6,256	6,256	7,256	7,256	7,256
8,000	2,361	6,361	7,361	6,361	6,361	7,361	7,361	7,361
10,000	2,361	6,361	7,361	6,361	6,361	7,361	7,361	7,361
12,000	2,256	6,256	7,256	6,256	6,256	7,256	7,192	7,256
14,000	2,043	5,929	6,679	5,929	5,929	6,679	6,337	6,892
16,000	2,043	4,824	5,681	5,160	5,458	6,208	5,560	6,421
18,000	1,986	3,698	4,555	4,383	4,986	5,736	4,783	5,949
20,000	1,515	2,571	3,428	3,606	3,857	5,006	4,006	5,478
22,000	1,017	1,423	2,281	2,803	2,709	4,203	3,203	4,980
24,000	496	496	1,115	1,979	1,544	3,379	2,379	4,459
26,000	(30)	(30)	(53)	1,151	376	2,551	1,551	3,933

Table B-3

Disposable Income of Lone Mothers not Collecting Social Assistance, Under Alternative Child Care Subsidy Schemes

Full-year Gross Earnings ($)	No Subsidy System ($)	Current Subsidy System - M1650 ($)	01650 ($)	M1625 ($)	M1950 ($)	01925 ($)	01425 ($)	Full Subsidy ($)
0	2,256	2,256	2,256	2,256	2,256	2,256	2,256	2,256
6,000	3,256	7,256	8,256	7,256	7,256	8,256	8,256	8,256
8,000	5,361	9,361	10,361	9,361	9,361	10,361	10,361	10,361
10,000	7,361	11,361	12,361	11,361	11,361	12,361	12,361	12,361
12,000	9,256	13,256	14,256	13,256	13,256	14,256	14,192	14,256
14,000	11,043	14,929	15,679	14,929	14,929	15,679	15,337	15,892
16,000	13,043	15,824	16,681	16,160	16,458	17,208	16,560	17,421
18,000	14,986	16,698	17,555	17,383	17,986	18,736	17,783	18,949
20,000	16,515	17,571	18,428	18,606	18,857	20,006	19,006	20,478
22,000	18,017	18,423	19,281	19,803	19,709	21,203	20,203	21,980
24,000	19,496	19,496	20,115	20,979	20,544	22,379	21,379	23,459
26,000	20,970	20,970	20,947	22,151	21,376	23,551	22,551	24,933

Notes

1 Martin Dooley, "Lone-Mother Families and Social Assistance Policy in Canada," in Dooley *et al.*, *Family Matters: New Policies for Divorce, Lone Mothers, and Child Poverty*, The Social Policy Challenge no. 8 (Toronto: C.D. Howe Institute, 1995), pp. 35-104.

2 Dooley, "Lone-Mother Families and Social Assistance Policy in Canada."

3 Patricia Evans, "A Decade of Change: The FBA Caseload, 1975-1986," Background Paper prepared for the Ontario Social Assistance Review, Toronto, 1987; Garry Barrett and Michael Cragg, "The Dynamics of Welfare Participation in British Columbia," draft paper, Sydney, Australia, University of New South Wales, Department of Economics, 1996.

4 Garry Barrett, "The Duration of Welfare Spells and State Dependence: Evidence from British Columbia," draft paper, Sydney, Australia, University of New South Wales, Department of Economics, 1996.

5 Gordon Cleveland and Douglas Hyatt, "Child Care, Social Assistance and Work: Lone Mothers With Preschool Children," HRDC Applied Research Branch, Strategic Policy, Working Papers no. W-96-2E (Hull: Human Resources Development Canada, 1996); and Lisa M. Powell "Family Behaviour and Child Care Costs: Policy Implications," *Policy Options*, Vol. 18, no. 1 (1997), pp. 11-15 for recent summaries.

6 The recent National Council of Welfare study, "Another Look At Welfare Reform" (Ottawa: National Council of Welfare, 1997), which reviews welfare reforms over the last five years, makes the point strongly that employment success depends as much on the willingness of employers to hire workers as it does on the willingness of welfare recipients to be employed.

7 W.S. Barnett, "Benefit-Cost Analysis of the Perry Preschool Program and Its Long-Term Effects," *Educational Evaluation and Policy Analysis*, Vol. 7, no. 4 (1985), pp. 333-42; W.S. Barnett, *The Perry Preschool Program and Its Long-Term Effects: A Benefit-Cost Analysis*, High/Scope Early Childhood Policy Papers no. 2 (Ypsilanti, Michigan: High/Scope Press, 1985); and W.S. Barnett, "Benefits of Compensatory Preschool Education," *Journal of Human Resources*, Vol. 27, no. 2 (1992), pp. 279-312.

8 Gordon Cleveland and Michael Krashinsky, in *The Benefits and Costs of Good Child Care: The Economic Rationale for Public Investment in Young Children* (Toronto: University of Toronto, 1998), calculate the potential child development and employment benefits, and the costs, of a major investment in preschool child care for two- to five year-old children.

9 See Gordon Cleveland and Douglas Hyatt, "Assessing Federal Child Care Policy: Does the Arrow Reach Its Target?", *Policy Options*, Vol. 18, no. 1 (1997), pp. 20-24; and Michael Krashinsky and Gordon Cleveland, "Rethinking The Rationales for Public Funding of Child Care," *Policy Options*, Vol. 18, no. 1 (1997), pp. 16-19, for review of the rationales for alternative child care policies. These articles include maternity/parental leave and benefits as the fourth leg of child care policy in Canada.

10 Apart from reviews of child care policy by federal government bodies, see Katie Cooke *et al.*, *Report of the Task Force on Child Care* (Ottawa: Status of Women Canada, 1986); and Special Parliamentary Committee on Child Care, *Sharing The Responsibility: Report of the Special Committee on Child Care* (Ottawa: Queen's Printer, 1987), there are partial critiques and some evidence provided in Gillian Doherty, Ruth Rose, Martha Friendly, Donna Lero and Sharon Hope Irwin, "Child Care: Canada Can't Work Without It," Occasional Paper no. 5 (Toronto: The Childcare Resource and Research Unit, University of Toronto, 1995); Martha Friendly, *Child Care Policy in Canada: Putting the Pieces Together* (Don Mills: Addison-Wesley Publishers Ltd., 1994); National Council of Welfare, "Child Care: A Better Alternative" (Ottawa: National Council of Welfare, 1988); Ruth Rose, "Les Coûts et les Bénéfices d'un Programme Éducatif Préscolaire, Universel, Facultatif et Gratuit: Estimation d'une Proposition du Conseil Supérieur de l'Éducation" (Montreal: Conseil Supérieur de l'Éducation, 1996); Gordon Cleveland, "Provincial Day Care Subsidy Systems in Canada" a Background Paper (Ottawa: Special Parliamentary Committee on Child Care, 1987) provides an interprovincial comparison of child care subsidy policies and calculations of number of families eligible. Jillian Oderkirk, "Eligibility for Child Care Subsidies in Canada: Selected Families, 1990" (Ottawa: Canadian Council on Social Development, 1993); and Jillian Oderkirk, "Moving From Welfare to Work: The Tax and Child Care Subsidy Tradeoffs for Different Family Types, Canada and the Provinces, 1992" (Ottawa: Canadian Council on Social Development, 1993) updates eligibility calculations and provides calculations of potential public finance effects of child care subsidies. There are no academic economic studies of the functioning of Canada's

child care subsidy policy, although Michael Krashinsky, *Day Care and Public Policy in Ontario*, Ontario Economic Council Research Studies no. 11 (Toronto: University of Toronto Press, 1977); and Lisa M. Powell, "Towards Child-Care Policy Development in Canada," in Terrance M. Hunsley (ed.), *Social Policy in the Global Economy* (Kingston: School of Policy Studies, Queen's University, 1993), pp. 155-81, provide theoretical perspectives on the purposes of child care subsidies. Cleveland and Hyatt, in "Assessing Federal Child Care Policy", provide data on the families who receive child care subsidy.

11 Another set of rules for subsidizing child care has evolved to serve families engaged in training at government expense. Beginning with Dependent Care Allowances under Employment and Immigration Canada and continuing under Employment Insurance, this has been supplemented by provisions under provincial training plans. In general, individuals who are engaged in training are eligible for a fixed amount of child care assistance per week, to be spent as the parent sees fit. The majority of these funds are used for the purchase of unlicensed care arrangements, partly because licensed care is not so widely available, does not offer part-time, short-term arrangements, and is not generally available outside standard daytime working hours.

12 In many provinces (or municipalities in the case of Ontario, which has separate subsidy eligibility rules in each municipality) there is a two-step eligibility process. The first step (social criteria) determines whether the parents (or lone parent) are employed, seeking employment, attending school, or in a training program. Eligibility for the second step (financial criteria) is, for all but parents or children with exceptional circumstances, conditional on being either employed or in preparation for employment.

13 Calculations by Oderkirk, "Eligibility for Child Care Subsidies in Canada", indicate that fewer than nine percent of two-parent families in Ontario, fewer than one percent in Quebec, and fewer than five percent of two-parent families in British Columbia are eligible for a full child care subsidy at current child care subsidy rates. Presumably, eligibility rates are similar in other provinces, where samples were too small for calculation. See Cleveland, "Provincial Day Care Subsidy Systems in Canada."

14 The policy should apply to lone fathers as well, although, for convenience, we discuss the situation of lone mothers, because they are overwhelmingly predominant amongst low-income, single-parent families.

15 Hillel Goelman and Alan Pence, "Effects of Child Care, Family and Individual Characteristics on Children's Language Development: The Victoria Day Care Research Project," in Deborah A. Phillips (ed.), *Quality in Child Care: What Does Research Tell Us?* (Washington, DC: National Association for the Education of Young Children, 1987); Suzanne Helburn et al., *Cost, Quality and Child Outcomes in Child Care Centers: Public Report* (Denver: Economics Department, University of Colorado at Denver, 1995); M.E. Lamb, "Non-parental Childcare: Context, Quality, Correlates and Consequences," in *Child Psychology in Practice*, volume editors, I.E. Siegel and K.A. Renninger, *Handbook of Child Psychology*, series editor W. Damon (5th ed.) (New York: Wiley, 1998).

16 All provinces but Ontario use an income test, and the relevant Ministry in Ontario has indicated a desire to switch.

17 She may also be eligible for dental and other medical payments for her family, but we do not include this in our calculations.

18 These families often lose dental and health benefits associated with social assistance, as well.

19 If the inefficient provision of subsidies to lone mothers with low employment earnings is a concern, child care subsidies can be restricted to those who work full or nearly full time and all year.

20 Cleveland and Hyatt, "Child Care, Social Assistance and Work: Lone Mothers With Preschool Children."

21 Dooley, "Lone-Mother Families and Social Assistance Policy in Canada."

22 Organisation for Economic Co-operation and Development, *Lone Parent Families: The Economic Challenge* (Paris: OECD, 1990).

23 Mark C. Berger and Dan A. Black, "Child Care Subsidies, Quality of Care, and the Labor Supply of Low-Income, Single Mothers," *Review of Economics and Statistics*, Vol. 74, no. 4 (1992), pp. 635-42; Stephen P. Jenkins, "Lone Mothers' Employment and Full-time Work Probabilities," *The Economic Journal*, Vol. 102 (1992), pp. 310-20; Jean Kimmel, "Child Care Costs as a Barrier to Employment for Single and Married Mothers," Working Paper, W.E. Upjohn Institute (October 1994); Jean Kimmel, "Effectiveness of Child Care Subsidies in Encouraging the Welfare-to-Work Transition of Low-Income Single Mothers," paper presented to American Economics Association meetings, 1995.

24 Dooley, "Lone-Mother Families and Social Assistance Policy in Canada."

25 Cleveland and Hyatt, "Child Care, Social Assistance and Work."

26 Dooley, "Lone-Mother Families and Social Assistance Policy in Canada." In this study he reports that the weekly earnings of young lone mothers working full-time were $421.00 in the early 1990's, or nearly $22,000 on a full-year basis.

27 Goelman and Pence, "Effects of Child Care, Family and Individual Characteristics on Children's Language Development," pp. 32, 89.

28 There can also be additional costs not recorded in Table 6. For instance, if the generosity of the subsidy system encourages young women to become lone mothers in order to access child care subsidies, the costs in Table 6 would be underestimated. Robert Moffitt, "Incentive Effects of the U.S. Welfare System: A Review," *Journal of Economic Literature*, Vol. 30, no. 1 (1992), pp. 1-61, reviewing the US evidence, finds little to suggest that family status is sensitive to social program generosity. Of course, some mothers in impermanent or new common law relationships may portray themselves as being lone mothers for the purpose of accessing child care subsidies.

29 National Longitudinal Survey of Children and Youth, *Growing Up in Canada: National Longitudinal Survey of Children and Youth* (Ottawa: Human Resources Development Canada and Statistics Canada, 1996).

IRPP Research Staff/
Personnel de recherche de l'IRPP
Monique Jérôme-Forget (president/présidente)
Robert Baril
Nicholas Ignatieff
France St-Hilaire

Executive Director/
Directrice exécutive
Marye Ménard-Bos

Series Editor/
Coordonnateur de la série
Robert Baril

Copy-editing
Patricia Lightfoot

Design & Production
Schumacher Design

Printing/Impression
Reprotech

IRPP
1470, rue Peel, bureau 200
Montréal (Québec)
H3A 1T1
Tel.: 514-985-2461
Fax: 514-985-2559
E-mail: irpp@irpp.org
Web site: www.irpp.org

Founded in 1972, the Institute for Research on Public Policy is an independent, national, nonprofit organization. Its mission is to improve public policy in Canada by promoting and contributing to a policy process that is more broadly based, informed and effective.

In pursuit of this mission, IRPP

- identifies significant public policy questions that will confront Canada in the longer term future, and undertakes independent research into these questions;
- promotes wide dissemination of key results from its own and other research activities;
- encourages non-partisan discussion and criticism of public policy issues by eliciting broad participation from all sectors and regions of Canadian society and linking research with processes of social learning and policy formation.

The IRPP's independence is assured by an endowment fund, to which federal and provincial governments and the private sector have contributed.

Créé en 1972, l'Institut de recherche en politiques publiques est un organisme national et indépendant à but non lucratif.

L'IRPP a pour mission de favoriser le développement de la pensée politique au Canada par son appui et son apport à un processus élargi, plus éclairé et plus efficace d'élaboration et d'expression des politiques publiques.

Dans le cadre de cette mission, l'IRPP a pour mandat :

- d'identifier les questions politiques auxquelles le Canada sera confronté dans l'avenir et d'entreprendre des recherches indépendantes à leur sujet;
- de favoriser une large diffusion des résultats les plus importants de ses propres recherches et de celles des autres sur ces questions;
- de promouvoir une analyse et une discussion objectives des questions politiques de manière à faire participer activement au débat public tous les secteurs de la société canadienne et toutes les régions du pays, et à rattacher la recherche à l'évolution sociale et à l'élaboration de politiques.

L'indépendance de l'IRPP est assurée par les revenus d'un fonds de dotation auquel ont souscrit les gouvernements fédéral et provinciaux, ainsi que le secteur privé.